

Message Text

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ACTION ARA-14

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C O N F I D E N T I A L LIMA 5936

E.O. 11652: GDS
TAGS: EGEN, ECON, EFIN, PE
SUBJECT: ECONOMIC CRISIS: PRIVATE SECTOR IS UNCERTAIN, APPREHENSIVE

REF: A. LIMA 5892; B. LIMA 5844

1. SUMMARY: PERUVIAN AND FOREIGN BUSINESS AND FINANCIAL LEADERS HERE HAVE REACTED WITH EXPRESSIONS OF UNCERTAINTY AND APPREHENSION TO RECENTLY ANNOUNCED CHANGES IN GOP ECONOMIC TEAM (REF B). THEY PRESUME THAT THESE CHANGES SUGGEST THE EMERGENCE OF AS YET UNDEFINED NEW ECONOMIC POLICIES, AND ARE FEARFUL OF THE MEDIUM AND LONG-RANG ECONOMIC CONSEQUENCES OF AN ABANDONMENT OF THE BARUA-PIAZZA-SANTISTEVAN ECONOMIC STABLIZATION PROGRAM.
END SUMMARY.

2. EMBASSY ECONOMIC/COMMERICAL COUNSELOR MET WITH LEADING PERUVIAN INDUSTRIALIST JULY 13 WHO WAS ACCOMPANIED BY EX-FINANCIAL EDITOR (DURING BELTRAN EAR) OF LA PRENNA. BOTH THESE WELL INFORMED PERUVIANS WERE EXTREMELY DISCOURAGED BY DISMANTLING OF ECONOMIC POLICY TEMA, AND WERE HIGHLY CRTICAL OF NEW APPOINTEES. EX-EDITOR, WHO HAS FOLLOWED PERUVIAN FINANCIAL SCENE FOR DECADES AND IS VERY WELL ACQUAINTED WITH PRINCIPALS
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INVOLVED, NOTED THAT WITH THE EXCEPTION OF BRIG GEN SAENZ (NEW FINANCE MINISTE) THESE NEW APPOINTEES WERE UNA DESGRACIA BECAUSE THEY KNOW ENOUGH ECONOMICS TO UNDERSTAND THAT THE NEW POLICY DIRECTIONS ARE DISASTROUS. AS FOR THE NEW MINISTER, HE COULD BE EXCUSED IN PART BECASUE OF HIS LACK OF INTELLECTUAL ABILITIES AND QUALIFICATIONS, THE FORMER NEWS-PAPER CONCLUDED. PERUVIAN INDUSTRIALIST ADDED TO FEELING OF

GLOOM MEETING BY NOTING THAT HE HAD REPORT FROM TRUSTED SOURCE IN HUANCAYO THAT DISTURBANCES THERE WERE FAR MORE SERIOUS THAN HAD BEEN OFFICIALLY ADMITTED, AND THAT THERE HAD BEEN A TOTAL OF PHERHAPS UP TO 50 DEATHS, WITH MANY WOUNDED AND HUNDREDS ARRESTED (REF A). (EMBASSY BELIEVES THESE FIGURES PROBABLY EXAGGERATED). INDUSTRIALIST ALSO NOTED THAT FACTORY MANAGERS AND SECURITY CHIEFS WERE ON ALERT TO GENERAL STRIKE THREATS JULY 18 (SEPTTEL). INDUSTRIALIST ATTRIBUTED PRESIDENT'S DECISION NOT TO MAKE SCHEDULED TRIP TO PIURA (REF A) TO SERIOUS PROBLEMS IN TRUJILLO AND ELSEWHERE IN NORTH.

3. IN MEETING JULY 14 WITH SENIOR OFFICIAL IN OFFICE OF LEADING US BANK HER, E/C COUN LEARNED MORE ABOUT GRAVE CONCERN IN FINANCIAL COMMUNITY OVER RECENT ECONOMIC TEAM CHANGES. THIS OFFICIAL HAD MET, TOGETHER WITH OTHER PERUVIAN AND FOREIGN BANK REPRESENTATIVES, WITH DR. GERMAN DE LA MELENA, PRESIDENT OF CENTRAL BANK, ON JULY 13, OFFICIAL REPORTED THAT PRIVATE SECTOR BANKERS ATTENDING MEETING WERE VERY DISAPPOINTED IN DE LA MELENA'S PRESENTATION, WHICH HE DESCRIBED AS EMBARRASSINGLY BUOYANT AND OPTIMISTIC. DE LA MELENA ANNOUNCED THAT THE EXCHANGE RATE SYSTEM WILL BE "FLEXIBLE" WITH MINI-DEVLUATIONS REPLACED BY INFREQUENT DEVALUATIONS OR REVALUATIONS (SIC) AS NECESSARY TO KEEP THE EXCHANGE RATE IN PROPER EQUILIBRIUM. IMPORTS WILL BE TIGHTLY CONTROLLED, AND THE BALANCE OF TRADE WILL BE FAVORABLE THIS YEAR. BALANCE OF PAYMENTS DEFICITS WILL BE COVERED BY BORROWING FROM ABROAD, DE
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LA MELENA REPORTEDLY SAID, INDICATING THAT NOT ONLY WOULD NEGOTIATIONS BE REOPENED WITH THE FUND BUT ALSO PRIVATE COMMERCIAL BANKS WOULD BE ASKED TO HELP OUT. IN THIS REGARD, DE LA MELENA CALLED ON LOCAL BANKERS AND FOREIGN BANK REPRESENTATIVES TO HELP "SELL" THE NEW ECONOMIC PROGRAM TO THE INTERNATIONAL BANKING COMMUNITY. THE DOMESTIC LIQUIDITY CRISIS WOULD BE SOLVED WITH THE INITIATION OF A LOOSER CREDIT POLICY, DE LA MELENA REPORTEDLY STATED, THOUGH HE WAS UNCLEAR AS TO DETAILS OF THIS PROPOSAL. (COMMENT: PRIVATE BANKERS ARE FEARFUL AS A RESULT OF THIS REMARK THAT THE NEW ECONOMIC TEAM MAY EXACERBATE PERU'S ALREADY SERIOUS INFLATIONARY PROBLEM. ALL IN ALL, THE CONSENSUS OF THE PRIVATE SECTOR BANKERS ATTENDING THE JULY 13 MEETING WITH DE LA MELENA WAS THAT PERU TODAY FACES THE DANGER OF PRECIPITOUS RETURN TO THE INCOMPETENCE OF OFFICIALDOM AND WRONG-HEADED ECONOMIC POLICIES THAT IN THEIR JUDGMENT CHARACTERIZED THE "FIRST PHASE" OF THE REVOLUTIONARY GOVERNMENT OF THE ARMED FORCES IN PERU).

4. AMONG THOSE IN FINANCIAL CIRCLES STILL HOPING THAT SOME ACCOMMODATION WITH THE IMF MIGHT BE REACHED, THE FIRST INDICATIONS OF THE NEW ECONOMIC POLICIES TO BE ADOPTED HAVE COME AS A SPECIAL DISAPPOINTMENT. FOR EXAMPLE, THE JUST-ANNOUNCED RE-

DUCTIONS IN THE PRICE OF BREAD AND PASTAS (POUCHING DETAILS TO DESK). WILL REQUIRE FURTHER CENTRAL GOVERNMENT SUBSIDIES OF IMPORTED WHEAT AT A TIME WHEN THE PUBLIC SECTOR BUDGET DEFICIT IS CLIMBING AT A RATE OF 5-10 BILLION SOLES PER MONTH, ACCORDING TO A RESPONSIBLE US BANK ECONOMIST WHO WAS IN LIMA RECENTLY. PIAZZA'S DREAM OF REDUCING THE PUBLIC SECTOR DEFICIT FROM 55 TO 32.5 BILLION SOLES IN 1977 (LIMA 5506) IS SHATTERED, WITH NO PROSPECTS YET THAT THE NEW ECONOMIC TEAM PLANS TO MOVE IN A MEANINGFUL WAY TO REDUCE CENTRAL GOVERNMENT BUDGETS. IT IS THE JUDGMENT OF AT LEAST ONE SENIOR US BANK OFFICIAL THAT THE IMF WILL NEVER, UNDER PRESENT CIRCUMSTANCES, AGREE TO A STANDBY, AND THAT US COMMERCIAL BANKS WILL ALMOST CERTAINLY NOT LEND ANY NEW FUNDS WITHOUT SUCH A STANDBY.

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5. THIS RAISES KEY QUESTION OF PERU'S FOREIGN DEBT SERVICE. LOCAL BANKING SOURCE INFORMED E/C COUNSELOR ON JULY 14 THAT PERU HAS SEVERAL LARGE OBLIGATIONS MATURING IN LATE JULY AND AUGUST 1977. IT HAD BEEN THOUGHT THAT PERU WOULD HAVE STANDBY IN JUNE OR EARLY JULY, AND WOULD HAVE COME TO SOME NEW ACCOMMODATION WITH US, CANADIAN, JAPANESE, AND EUROPEAN BANKS BY NOW, THIS BANKING SOURCE POINTED OUT. WITH NO STANDBY, THE QUESTION OF FORCED RESCHEDULING IS VERY MUCH IN BANKERS' MINDS THESE DAYS, WITH OBVIOUS DELEGTERIOUS EFFECTS ON PERU'S CREDIT WORTHINESS. IN THIS REGARD, PERU CAN NOW EXPECT TO HAVE SERIOUS PROBLEMS IN OBTAINING SHORTER TERM FINANCING FROM FOREIGN BANKS AS REGULAR CREDIT LINES BECOME INCREASINGLY LESS AVAILABLE.

5. COMMENT: IT IS CLEAR THAT PERU IS NOW IN THE MIDST OF A SEVERE ECONOMIC CRISIS AGGRAVATED BY DISORDERS AND THREATENED GENERAL STRIKE (SEPTTEL) THAT COULD HAVE ITS EFFECT ON THE VERY POLITICAL STABILITY OF THE COUNTRY. THE LONG PROCESS FACING THE REVOLUTIONARY GOVERNMENT OF REBUILDING CONFIDENCE ON THE PART OF THE GENERAL PUBLIC, AS WELL AS KEY PRIVATE SECTOR BUSINESS AND FINANCIAL LEADERS, HAS NOT YET EVEN BEGUN. THUS IT WOULD BE AN OPTIMISTIC OBSERVER INDEED (AND WE HAVE NOT MET ANY IN LIMA IN RECENT DAYS) WHO SAW UNTRoubLED TIMES AHEAD FOR THE PERUVIAN PEOPLE AND THEIR LEADERS.
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